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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 001068

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SUBJECT: PRESIDENT ALIYEV REVIEWS THE BILATERAL ECONOMIC
RELATIONSHIP AND IRAN WITH EEB A/S SULLIVAN

REF: A. BAKU 953

[1](#)B. BAKU 1006

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Classified By: Ambassador Anne E. Derse per 1.4 (b,d).

[1](#)1. (C) Summary: In an August 15 meeting with visiting EEB A/S Sullivan and the Ambassador, President Aliyev said that he recognized the need to diversify Azerbaijan's economy and also was aware of the dangers of inflationary pressures. Aliyev hopes to address these issues by combining the State Entrepreneurship Fund and Azerbaijan Investment Company to increase state investment in the non-energy sectors; he argued that significant investment is needed in infrastructure and social areas. Aliyev acknowledged that corruption is a serious problem, and said his goal is to create an economic situation that makes corruption impossible. He believes the EU action plan is key to his efforts, as it will introduce EU criteria. Aliyev affirmed his support for WTO accession but argued that Azerbaijan must protect itself from Russian and Iranian economic influences. Sullivan briefed Aliyev on U.S. diplomatic efforts to halt Iranian nuclear programs, and urged Aliyev to keep in mind U.S. views during Ahmadinejad's August 21-22 visit to Baku. Aliyev assured Sullivan that Ahmadinejad's visit would be "short, without significant political statements." End summary.

[1](#)2. (C) In a relaxed, 90-minute meeting with visiting EEB Assistant Secretary Sullivan and the Ambassador, President Aliyev reviewed the bilateral economic relationship and Iran. He also discussed recent regional energy developments (septel). President Aliyev was accompanied by Economic and Energy Advisor Ali Asadov. USTDA General Counsel Jim Wilderooter, DOE's Tyler Tiller, EEB/ESC Rob Garverick and Pol/Econ Chief (notetaker) also attended the meeting.

Assessing the Economic Partnersip Commission

[1](#)3. (C) Emphasizing that the U.S. is committed to helping Azerbaijan achieve prosperity and economic stability, as well as diversification, Sullivan told Aliyev that the U.S. views the bilateral Economic Partnership Commission (EPC) as an important vehicle to achieve these goals. Sullivan noted that diverse issues such as WTO accession and anti-corruption

and anti-inflationary measures are in fact interwoven and, tackled together, can strengthen Azerbaijan's macroeconomic stability and prosperity. Sullivan told Aliyev that the private sector is deeply concerned that corruption trends in Azerbaijan are moving in the wrong direction; the U.S. also is concerned by recent inflationary pressures. Diversification of Azerbaijan's energy-focused economy will also strengthen Azerbaijan's independence and prosperity. Sullivan noted that he would review the goals articulated in the joint EPC communique with Minister of Finance Sharifov later in the day.

14. (C) Aliyev responded that he is aware of the need to diversify Azerbaijan's economy. The World Bank recently projected that, at USD 50/barrel, Azerbaijan will have USD 200 billion in energy revenue over the next 20 years. With that revenue, Aliyev said he plans to invest "a lot" in Azerbaijan's non-energy sector. Aliyev said he had instructed the Ministry of Economic Development to consider combining the Fund for Entrepreneurship with the Azerbaijan Investment Company. If these two entities are combined, Aliyev plans to give the new organization an extra USD 100 million per year, bringing its total investment capital to USD 300 million per year. Aliyev said the state, through this new entity, would provide 20 to 25 percent of start-up capital needed for new projects and would plan to sell its shares after the project was on its legs. He added that the GOAJ already is investing in IT, social infrastructure, roads and power stations, and is increasing salaries and pensions twice a year.

15. (C) Aliyev said he is well aware of growing inflationary pressures. The current inflation rate is 15 percent and is expected to double in the next decade. Aliyev attributed recent rises in inflation to January increases in utility tariffs, the effects of which still are reverberating through the economy. Electricity tariffs, Aliyev noted, had tripled,

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but the increase had allowed the GOAJ to normalize the energy sector. Consumption had decreased by 12 percent, Aliyev said, and domestic gas consumption had dropped by 100 million cubic meters (mcm). The GOAJ also had installed gas meters, an important anti-corruption measure that eventually will include pre-paid cards. Aliyev noted that similar electronic measures already had been put in place for the distribution of salaries and pensions, a development that he argued had reduced corruption.

What Can We Do? Arrest Everyone?

16. (C) Aliyev said this his goal is to create an economic situation that makes corruption impossible. He acknowledged that Azerbaijan still has "the unjustified involvement of regulating ministries in the economy" but claimed that this involvement is decreasing. Aliyev said that he has made a point of naming successful businessmen to his cabinet and to the notoriously corrupt local administrations (ExComms), as these already wealthy individuals would have no reason to engage in corrupt activities. Aliyev pointed to Minister of Labor and Social Welfare Fizuli Mammadov (one of Aliyev's close personal friends) as an example of his successful policy.

17. (C) Aliyev acknowledged that corruption is a serious problem in Azerbaijan, laughing that "corruption in the United States is an exception but in Azerbaijan, it is the other way around." "What can we do," Aliyev asked, "arrest everyone?" Aliyev argued that Azerbaijan needs to pursue a mixed approach of prosecution, reform, careful appointments, and salary increases. He said that salary increases in Azerbaijan's road police had led to a "dramatic" decrease in corruption. While Aliyev acknowledged that he could not say that he had eradicated 100 percent of the corruption in the road police, he said that only ten percent remains.

(Comment: The average Azerbaijani motorist, regularly stopped for bribes of ten to twenty manat -- USD 12 to USD 24 -- likely would disagree.)

¶18. (C) Aliyev said that, from his perspective, the main importance of Azerbaijan's new EU action plan was that it would bring Azerbaijan to EU standards. "We know they (the EU) won't accept us now," Aliyev said, but "we need their criteria." Continuing that Azerbaijan does not want to be like Iran or "even" Turkey, Aliyev said that Azerbaijan intends to "keep our national identity" but adopt a "European management style." Aliyev mused that "maybe we'll adopt a European political system -- but not exactly -- because it will not work here."

Inflation and the WTO

¶19. (C) Turning again to inflation, Aliyev said that Azerbaijan's consolidated 2007 state budget totaled USD 9 billion, a massive increase over the last four years. The 2003 state budget, Aliyev noted, was only USD 1.5 billion. This rapid increase in state spending included sorely needed infrastructure investment. Given the massive amounts of government revenue and expenditure, Aliyev said the GOAJ needed strengthened financial controls and greater transparency, such as already exists in the State Oil Fund (SOFAZ). For this reason, Aliyev said, he had appointed former SOFAZ head Samir Sharifov as Minister of Finance. Aliyev said he told Sharifov to bring the same degree of transparency to state financial processes that he had brought to SOFAZ.

¶10. (C) Affirming his support for WTO accession, Aliyev said Azerbaijan is in the process of finalizing its protocols. He had asked the Ministry of Economic Development to draft two papers, outlining the "plusses and minuses" of WTO accession. "We need to minimize the negatives while preserving the benefits," Aliyev said, and "identify minuses that are not so dangerous for Azerbaijan." "WTO accession is in our program," Aliyev emphasized. "The rest of the world is in the WTO and we cannot be the exception."

Fears of Economic Domination

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¶11. (C) Aliyev cautioned, however, that Azerbaijan must protect itself. Azerbaijan's neighbors also are benefiting from increasing oil prices, and they do not have mechanisms of control. Russia, for example, is using its oil money to influence events in Azerbaijan. "I put barriers against Russian oligarchs' investment," Aliyev said. "Only Lukoil is here, and that is because we needed them in the early days." "Now," Aliyev continued, "pipeline and mobile phone companies are trying to come here. If we open up completely, they will come. How can I protect myself?" Aliyev asked. "From Iran too," he pointedly added. "At this stage, we cannot open completely our market. Economic domination will lead to political domination. We have been a colony of Russia and Persia for centuries. We must protect our independence and work toward Euro-Atlantic integration," Aliyev concluded.

¶12. (C) Sullivan responded that he would work to encourage deeper U.S. private sector engagement with Azerbaijan, particularly since U.S. firms would bring high standard, world-class technology, management training, and a commitment to building local capacity. The ambassador added that it was strategically important to increase U.S. investment, for the reasons that President Aliyev had outlined. To that end, the Ambassador had reached out to the U.S. Business Roundtable, who had invited her to speak about opportunities in Azerbaijan. The Ambassador hoped that she could share a good news story about the steps the Government of Azerbaijan had taken to level the business playing field. She noted that

business representatives believe real corruption issues remain, and suggested that President Aliyev revive his former practice of regular meetings with the business community, as requested by the AmCham. Nodding his head, Aliyev said that Azerbaijan had a "good experience" working with the U.S. companies. The GOAJ partners successfully with many of the world's leading energy corporations, and wants to have the same degree of partnership in the non-energy sectors.

Containing Iran

113. (C) Sullivan briefed Aliyev on U.S. efforts to address Iranian nuclear weapons programs via diplomacy and economic sanctions. In addition to the UNSC sanctions, the U.S. has been talking to major European companies, especially in the energy sector, to discourage involvement in Iran. There has been increasing cooperation from financial capitals to shut off Iranian financial transactions, and most European countries have dramatically decreased their export credits to Iran. This diplomacy is working, Sullivan said, and the Iranian economy is feeling the effects. Iran's nuclear programs are not an issue between the U.S. and Iran; they are an issue between Iran and the international community. Noting the USG's previous discussions with Aliyev on Iran (reftels), Sullivan said he hoped that Aliyev would keep this in mind during Iranian President Ahmadinejad's August 21-22 visit to Baku.

114. (C) Commenting that "only a unified approach can force change in Iran's nuclear policy," Aliyev said that the U.S. diplomatic achievements with respect to Iranian business activity were very important. Iran is not isolated, Aliyev continued, and has close cooperation with major U.S. allies. "We are very concerned about Iran's activities and ambitions in the region," Aliyev said. Iran is trying to impose its values everywhere, Aliyev continued, but this did not happen in Azerbaijan. Iran is "always a difficult issue for us," Aliyev said. There is "no big economic relationship" between Iran and Azerbaijan; the only real trade ties are the transport links and energy swaps between Nakhchivan and Iran, trade that Aliyev pointedly noted would cease with a resolution of the Nagorno-Karabakh conflict. "We don't have investment in Iran and we don't allow it here," Aliyev stated. On the other hand, Aliyev noted that the GOAJ is investing heavily in education and social infrastructure in its southern areas bordering Iran, to counter persistent Iranian attempts to influence political and social trends there. Aliyev added that the GOAJ has taken "serious measures" to against Iranian-sponsored intelligence agents. Aliyev assured Sullivan that Ahmadinejad's visit "will be short, without significant political statements." He added that Azerbaijan simply could not postpone this visit any

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longer.

115. (C) Aliyev concluded that for Azerbaijan and the region, an Iran with nuclear weapons would be a disaster. He said that he hoped international efforts to change Iran's nuclear policy would prove successful. Aliyev commented that, in the past, Iran had portrayed itself as the protector of Islamic countries. However, Iranian policy toward Armenia -- which Aliyev pointedly noted "cleansed 700,000 ethnic Azeri Muslims and occupies 20 percent of Azerbaijan's territory" -- reveals the hypocrisy of Iran's claims.

116. (U) A/S Sullivan cleared this message.
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